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ABSTRACT

This group of four papers considers the future of the cable television industry, and in particular, examines the impact of recent court and regulatory decisions in this field. The papers presented are: (1) "The First Amendment, Cable TV, and the Must-Carry Rule: Moving towards a Cost-Benefit Analysis" (John R. Woodbury, Federal Trade Commission); (2) "The Cable Act Revisited: The Public Interest versus the Cable Monopoly--A White Paper" (Nicholas P. Miller of the law firm Miller, Young and Holbrooke); (3) "Franchise Overbuilds: The Cable Industry's Challenge" (Frank W. Lloyd of the law firm Mintz, Levin, Cohn, Ferris, Glovsky and Popeo); and (4) "Recent Developments in Cable Law: 1987" (Alan Ciamporcero, Larrine S. Holbrooke, and Nicholas P. Miller of the law firm, Miller, Young and Holbrooke). (EW)

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TELECOMMUNICATIONS POLICY RESEARCH CONFERENCE

Future of Cable TV Section

Airlie, Virginia

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The First Amendment, Cable TV, and the Must-Carry Rule: Moving Towards a Cost-Benefit Analysis

by

John R. Woodbury*
Federal Trade Commission

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FUTURE OF CABLE TV
Chair: Dan Brenner

John Woodbury: Regulating Cable TV: The Case of Must Carry

The Federal Communications Commission recently modified its rules requiring the carriage of certain local broadcast stations by cable television systems. Unlike the original must-carry rules adopted in 1966, the modified rules substantially reduce the number of local signals that cable systems are required to deliver to their subscribers. The most important innovation in the modified rules is its sunset provision, mandating the automatic demise of must-carry five years after the effective date of the modified rule. Whether that provision will survive Congressional dissatisfaction remains to be seen.

In the most recent must-carry debate, two familiar reasons were offered for continued retention of some form of the rules. First, local broadcast stations have been and remain the chosen instrument of the Commission for pursuing the goal of localism. Because this policy has never been clearly defined and is therefore never refutable, this"argument" provides a safe harbor for those interests advocating retention of the favored regulatory position of broadcast television.

The second primary argument focuses on the alleged monopoly power of cable TV systems. Contemporary advocates of must-carry contend that because of their monopoly power, cable operators will have an incentive to skew their carriage towards the cable or satellite programming services and away from local broadcast television.

Despite the sound and fury that the must-carry debate has generated since 1966, no one to my knowledge has ever provided any sound empirical data on what a world free of must-carry might look like. The empirical analysis in this paper can be viewed as filling this void.

The paper relates the carriage of local broadcast signals by unregulated cable systems to a number of market and system characteristics and using that relationship predicts the number of local signals carried for a variety of systems in different market environments. Regardless of whether one views unregulated and regulated cable systems as monopolistic or

competitive, the paper at a minimum provides policy-makers with a component of their cost benefit analysis: a way of gauging the gap between the theoretically "ideal" extent of local station carriage and that occurring in an unregulated environment.

Recently, in a policy deja vu, the Federal Communications Commission announced adoption of a rule mandating the carriage of local television signals by cable systems servicing the local area.[1]

A so-called "must-carry" rule was first adopted by the FCC in 1966,[2] requiring cable systems to carry all local television stations.[3] The must-carry rule was one of a number of rules promulgated by the FCC between 1966 and 1972 to limit the impact of cable on broadcasters and on localism.[4] By 1980, most of these rules had been either overturned by the courts or eliminated by the FCC as evidence mounted that the growth of cable would have only a minimal impact on broadcast stations.[5] Following a decision by the Court of Appeals of the District of Columbia that the must-carry rule violated the First Amendment

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[1] See Report and Order in the Matter of Amendment of Part 76 of the Commission's Rules Concerning Carriage of Television Broadcast Signals by Cable Television Systems, MM Docket No. 85-349, adopted August 7,1986.

[2] In the Matter of Rules re Microwave-Served CATV, Second Report and Order in Docket No. 14895, 2 FCC 2d 725 (1966).

[3] 47 C.F.R. Parts 76.57 - 76.61 (1984)

[4] For a complete history of these rules, see S. Besen and R. Crandall, "The Deregulation of Cable Television," Law and Contemporary Problems, Vol. 44, No. 1 (Winter 1981), at 85-97 (hereafter, Besen and Crandall).

[5] See Besen and Crandall at 103-106.

rights of cable operators,[6] the FCC narrowed the scope of the rule. The new rule conditions the extent of mandatory carriage of local broadcast stations on the channel capacity of the cable system and in some circumstances permits cable operators the discretion to drop duplicate signals and signals of stations not widely viewed. The new rule also contains a five-year sunset provision.

The FCC adopted the original and modified must-carry rule in response to two related concerns. First, the Commission viewed any failure by cable systems to carry local broadcast stations as an "unfair competitive" practice.[7] Second, the Commission believed that such a failure would adversely affect the growth of local broadcast stations as outlets for local expression.[8] In responding to the Commission's request for comments on the new rule, parties urged two conflicting views of the likelihood that cable systems will carry local broadcast stations in the absence of a must-carry rule. Some parties argued that cable operators, for apparently monopolistic reasons, will decline to carry many

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[6] Quincy Cable TV, Inc. v. FCC, 768 F.2d 1434 (D.C. Cir. 1985).

[7] In the Matter of Rules re Microwave-Served CATV, Second Report and Order in Docket No. 14895, 2 FCC 2d 725 (1966). For purposes of this analysis, we interpret "unfair competitive" practice as an anticompetitive practice.

[8] Id.

local broadcast stations.[9] Others argue that cable operators will carry local stations because it will be profitable to do so.[10] To the extent that this second view is correct, any public interest basis for the imposition of a must-carry rule would appear to be a closer call.

A. Costs, Benefits, and First Amendment Considerations

At the outset, it should be noted that even in a fully competitive video distribution market, any given cable system will not necessarily carry all local television stations. Because additional channel capacity is costly, one would no more expect an unregulated competitive cable operator to carry all local television signals than one would expect the operator to carry all satellite programming services or the local convenience store to carry every brand of cereal or coffee.

While this point seems obvious, the reason for belaboring the obvious is that many advocates of regulatory controls on the programming choices of cable and other program providers and

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[9] See, e.g., Comments of The National Association of Broadcasters at 28-30; Comments of The Television Operators Caucus at 17-19; Comments of The Association of Independent Television stations at 67-68. These comments were filed in the FCC's most recent must-carry rulemaking, MM Docket No. 85-349.

[10] See, e.g., Comments of The National Cable Television Association at 20-21; Comments of The Department of Justice at 19.

distributors (such as ABC, NBC, and CBS) appear to engage the monopoly argument only as a first line of defense. This may be so because the observation that unregulated cable operators would not carry all local stations is consistent with either the competition hypothesis or the market power hypothesis.

Thus advocates of regulatory controls resort to a second line of defense. Even if the video production and distribution system were perfectly competitive and even if there were no conventional public good problems associated with programming, these advocates argue that First Amendment concerns (usually framed in terms of the need for ownership and program diversity, concepts which encompass localism) dictate that access by program providers to the video distribution system be greater than that forthcoming in a competitive environment.

This line of attack is frustrating for many economists who have studied the video marketplace because as far as I am aware no advocate of this kind of First Amendment argument has been willing to offer explicit criteria by which one can empirically judge when sufficient access to the video system has been attained, let alone why the access provided in a competitive market is inadequate. The watchwords for such advocates appears to be that more access is preferred to less, with only a token acknowledgement at best that mandating greater access is not a free lunch. Merely uttering the phrase "greater diversity" is

regarded as ample justification for regulatory policies designed to provide greater access. Without any concrete definition of the externality that girds the First Amendment arguments of these advocates, a complete quantitative cost-benefit analysis of alternative regulatory regimes is of course impossible. As a result, economists can only indicate quantitatively and qualitatively some of the cost-benefit considerations that should at least be part of the policymaker's decision calculus.

The research I offer here is in this spirit. I begin with the presumption that a must-carry rule if effective has costs and benefits, both of which are at least in part a function of the number of signals whose carriage is required by a rule beyond the number that would be carried by an unregulated cable system. I adopt the conventional assumptions that as the number of stations carried increases the additional consumer benefits from requiring the carriage of one more broadcast station decline while the additional costs rise. Thus the more broadcast signals that an unregulated cable operator would carry, the smaller the net consumer benefits from a must-carry rule will be.

In order to at least qualitatively render a policy judgement as to whether a must-carry rule is required and if so, what the scope of that rule should be, the starting point must be the number of broadcast signals that would be carried absent the rule. To estimate local signal carriage absent a must-carry rule,

I examine the carriage of local stations in a sample of satellite master antenna television (SMATV) systems. Like cable systems, SMATV systems provide video programming (both local broadcast stations received off-air and programming received via satellite) to their subscribers via a coaxial cable.

In two respects worth mentioning, SMATV systems are unlike cable. First, and most importantly for this analysis, SMATVs are typically unregulated by either federal or local authorities. Thus their programming selection decisions are not fettered by regulatory restrictions. Second, SMATV systems are also referred to as "private cable" since unlike conventional cable systems, SMATVs typically do not utilize public rights of way (and because of this, SMATVs escape local regulation). However, because SMATVs do not use public rights of way, they tend to restrict their activities to larger apartment buildings.

If SMATVs and cable systems can be viewed as economically analogous (that is, if they possess approximately the same degree of market power, including none), then the kind of analysis presented below can be used directly to predict the extent of cable carriage of local broadcast signals in the absence of a must-carry rule. Based on such an analysis, the Commission could use the results of the SMATV analysis to more accurately assess the costs and benefits of requiring local station carriage beyond

that which would be carried by an unregulated system.[11] Because such an analysis could be tailored to the individual characteristics of different markets (such as the availability (number and kind) of local stations and of satellite programming services), the costs imposed as a result of a rule which ignores those characteristics could be reduced.

If cable is regarded as possessing more market power than SMATV, the kind of analysis offered in this paper can be used in the following fashion. First, in place of an inflexible rule, the SMATV analysis can be used as a rebuttable benchmark to mandate minimum cable carriage of local broadcast stations. For example,

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[11] If cable and SMATV are viewed as economically analogous, then the costs and benefits of any additional carriage requirements would depend upon the number of stations that would be carried by an unregulated operator (as predicted by the SMATV analysis) and on judgments regarding the extent to which cable and SMATV are monopolistic, the amount of carriage that would be forthcoming in a competitive environment, and the additional amount of carriage dictated by First Amendment concerns. Because these judgments will be held with varying degrees of confidence, the policymaker may rationally conclude that if the number of local stations carried by an unregulated cable operator is large, imposing additional carriage requirements is much more likely to generate net costs rather than net benefits. Therefore, the policymaker may decline to adopt a must-carry rule. Similarly, if the number of stations carried by the unregulated cable operator is small, the imposition of additional requirements may be more likely to generate net benefits rather than costs. This last outcome is more likely if one judges that cable and SMATV are monopolistic and if there is a wide gap between the monopolistic and competitive carriage of local stations by unregulated cable systems.

While the analysis here cannot aid in forming these judgments, the extent to which unregulated cable systems would carry local stations should be a key factor in rendering a final decision on a must-carry rule in light of the imperfect information upon which these policy judgments must be made.

an unregulated cable operator may carry only 3 of 7 local stations. If the SMATV analysis predicts that in the kind of market environment in which cable operates, the more competitive SMATV would carry 5 of the 7 stations, the FCC could mandate that the cable operator carry an additional two stations unless the cable operator could provide convincing evidence that in that particular market environment the SMATV analysis overstates the amount of local carriage.

Second, having required that this particular cable operator carry the additional two stations, the FCC could then judge whether mandating even more carriage would generate net consumer benefits. While I have not attempted to do so in this paper, it is probably quite possible for the Commission to develop easily applicable criteria to determine the circumstances in which and the extent to which carriage of local broadcast signals should exceed that predicted by the SMATV analysis.[12]

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[12] My own view is that cable and SMATV systems tend to be more alike than different. Cable and SMATV face the same competitors in the video marketplace (such as local broadcast stations, video cassette recorders, and multichannel multipoint distribution services) and compete with each other for access to apartment buildings. For this reason and the following reason, the two-step procedure is unlikely to be relevant. If cable systems tend to have market power and if SMATVs are only fringe competitors to cable, then in the spirit of the dominant firm model, SMATVs would mimic the program offerings of cable. While the two distribution systems are not economically analogous, their carriage of programming would be. In this case, the economically analogous analysis would apply, including the regulatory judgments described in the previous note.

I regard the analysis presented here as the prototype of the analysis that is the first step in this kind of more studied cost-benefit analysis of a must-carry rule. It is a prototype because, as I note below, the sample of SMATVs used in this analysis is relatively small. As a result, there are a number of factors that likely affect the extent of local station carriage by SMATV systems that I could not take into account. These include the demographics of the subscriber population and reception difficulties.[13] While cost considerations required that I rely only on published information regarding SMATV systems, the small sample size problem can be resolved by collecting the data directly from SMATVs.

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[13] Because the characteristics of apartment buildings may lead to poorer over-the-air reception than might be the case for individual residences, the extent of SMATV carriage of local broadcast stations may be greater than that for unregulated cable systems. Rather than provide those local broadcast stations via cable to their subscribers, cable systems may elect to carry fewer stations (those for which reception is more problematic), and subscribers would receive the remaining stations over-the-air via an A/B switch. Thus while the SMATV analysis may overstate the likely carriage of local stations by unregulated cable systems (if cable and SMATV are economically analogous), it would probably not overstate the number of signals capable of being received by cable subscribers. It also would likely be relatively inexpensive for a cable operator to demonstrate to the Commission that the shortfall in local signal carriage of the cable system as compared to that predicted by the SMATV analysis is attributable to the superior quality of off-air reception. The significance of omitting the reception-quality factor may not be great. In their comments to the FCC on a new must-carry rule, the National Association of Broadcasters and the National Cable Television Association argued that the use of an A/B switch in conjunction with cable would be inordinately expensive and/or would fail to provide subscribers with the reception quality available off-air. But see the discussion of the SMATV sample in the text below.

B. The SMATV Sample

Our sample consists of 24 SMATV systems, the data for which were culled from individual system descriptions in the SMATV Newsletter[14] over the period 1981-85. Complete descriptions of SMATVs typically included information on how many local off-airs were carried (but not which ones were carried) and either the number of satellite programing services carried or the total channels offered subscribers, or both.

Two apparent biases to our data set should be noted. First, the largest SMATV system in our sample has only 24 channels. While larger SMATVs exist, the SMATV Newsletter descriptions were considerably less detailed as the number of channels available to subscribers increased. The significance of this bias is discussed below. Second, a number of SMATV systems described did not provide any local broadcast stations to their subscribers via cable but made these stations available to subscribers via an A/B switch, a master antenna, or both. Although we could have assumed that these systems made all local stations available to their subscribers, we instead deleted these systems from our sample.[15] As a result, the tendency of SMATVs to provide their

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[14] Paul Kagan and Associates, Inc.

[15] This means that we deleted from our sample SMATV systems whose subscribers presumably could have received every local station simply by flipping an A/B switch.

subscribers with local broadcast stations may be understated. On this score, our estimates will be conservative.

C. The proportion of off-airs selected for SMATV carriage

Carriage of local stations appears to be profitable for SMATVs. If the profitability of carrying local stations tended to be less than the profitability of carrying satellite services, the limited number of channels offered by SMATVs in our data set suggests that we should observe a low proportion of SMATV channels devoted to local broadcast stations. In fact, however, local stations occupy, on average, 46 percent of the SMATV channels offered, with individual system percentages ranging between a low of 34 percent and a high of 67 percent. Because the number of satellite services from which a SMATV could choose ranged between 40 and 50 over the 1981-85 period, this evidence does not support a conclusion that SMATV carriage discriminates against local broadcast stations. Instead, it appears reasonable to conclude that SMATVs typically found local station carriage profitable.[16]

While the above analysis suggests that SMATVs on average tend to devote nearly half of their channels to local off-airs,

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[16] A complete statistical analysis of these proportions can be found in Appendix A.

this does not of course mean that all or even most local off-airs were carried by the SMATV. We therefore focused on the proportion of local stations carried by SMATVs.[17]

Specifically, we examined how this proportion varies with the number of SMATV channels, the number of available satellite programming services, and the characteristics of the local broadcast stations. Because all of our observations were in markets that had at least three unduplicated network affiliates (i.e., an ABC affiliate, a NBC affiliate, and a CBS affiliate) we could not examine how the number of local stations carried varied with the number of unduplicated affiliates. Thus, our "benchmark" case is a market which contains three unduplicated affiliates.

For purposes of predicting the outcomes of our statistical exercise, we hypothesized that the difference between the number of local stations carried by a SMATV and the number available would be lowest when only three unduplicated affiliates were available in the market. While the availability of additional local stations could reduce this difference, this could occur only if other local stations had a higher probability

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[17] Ideally, we would have liked to examine the relationship between the factors described below and the probability that a particular station type (for example, independent or educational) is carried by a SMATV. Such an examination would require information regarding which stations were carried by each SMATV. Our data source did not provide that information.

of being carried than at least one of the network affiliates.[18] Thus, it may be more reasonable to predict that the proportion of local stations carried by SMATV falls (but the number of stations carried rises) as the number of local independent, educational, and duplicate affiliate stations increases.

Finally, we predict that an increase in the availability of alternative satellite programming services will tend to reduce the number of local stations carried. The greater the number of satellite alternatives, the more likely it may be that the profitability of carriage of some local stations drops in the programming array.[19]

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[18] Most previous theoretical and empirical research indicates that the various types of stations carried have different effects upon the demand for cable service. Carriage of unduplicated network affiliates tends to have the greatest demand impact while carriage of educational, independent, and duplicate network stations have smaller effects. See the discussion in Appendix B.

[19] In statistically examining the relationship between these factors and the proportion of local stations carried, there is a danger that the statistical process will yield estimates of the SMATV proportion exceeding unity. In order to resolve this problem, we utilize a commonly-used functional relationship which insures that any estimate will be within the zero-to-one range. The nature of the technique is such that the proportion of stations carried when there is (e.g.) one duplicate affiliate in the market will always be higher than when there are two (assuming our predictions are correct). The estimated proportions will first decrease gradually and then decrease at an increasing rate as the number of (e.g.) duplicate affiliates increases. In general, this appears to be an appealing characteristic. This behavior would be consistent with the hypothesis that carriage of a second duplicate affiliate is not as profitable as carriage of the first. However because the proportion of stations carried declines more rapidly as the number of duplicate affiliates grows, it is possible at some

(continued...)

In general our results were as predicted. An increase in the number of available local independents and duplicate affiliates increases the number of local stations carried by SMATV. However, as predicted, the increase in the number of local stations carried is lower than the increase in the number of local stations available over-the-air. In addition, an increase in the availability of satellite services tends to reduce the number of local stations carried. These relationships are all significant at conventional levels of statistical confidence.[20]

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[19](...continued)
point for the estimated total number of stations carried by SMATVs to decline. While this behavior is not entirely implausible, it does suggest the results may not be reliable when the proportion of stations carried is low.

[20] While the relationship between the number of SMATV channels and the proportion of local stations carried was always positive (i.e., an increase in SMATV channels is associated with an increase in the proportion of local stations carried), that relationship was not statistically significant in the procedure that distinguished among the various types of local stations (independent, educational, duplicate affiliate) available in the market. Because the relationship was significant when this distinction among station types was not made, we suspect that the problem is attributable to our relatively small sample.

The only real anomaly was the relationship between the number of educational stations and the proportion of local stations carried. Instead of the predicted negative relationship, the statistical analysis typically indicated that an increase in the number of educational stations increases the SMATV proportion of local stations carried. While this certainly could be true, we again suspect that our small sample is the culprit. However, unlike the number of SMATV channels, this particular relationship was never statistically significant.

Table 1 indicates the sensitivity of the estimated number of stations carried by SMATV to both the number of stations available in the market and the number of SMATV channels offered, under the assumption that the number of available satellite services is 45.[21] First, for any given number of available local stations, the number of stations carried increases with the number of channels offered.[22] Second, for any given number of channels utilized, the number of stations carried tends to increase as the number of local stations available increases. The increase is larger for larger channel systems.[23]

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[21] The number of available satellite video services in 1985 was 46. Satellite Services Report, May 1985 (National Cable Television Association). Because the maximum channel capacity in our sample is 24, some caution is warranted in those simulations in which the channel capacity exceeds this maximum.

[22] For example, if the number of available stations is seven (four independents), a 13-channel SMATV will offer about four of those stations to its subscribers while a 35-channel SMATV will carry between five and six local stations.

[23] For example, in a market with four stations available (one independent), a 13-channel SMATV will offer subscribers around three stations; a 35-channel SMATV will offer about four. In a market with seven stations available (four independents), the 13-channel system will offer about one additional local broadcast station while the 35-channel SMATV will offer about two additional over-the-air stations.

The tale for duplicate affiliates and for a market consisting of eight stations (three independents, three unduplicated affiliates and two duplicated affiliates) is similar. As channel capacity increases, SMATV's tend to carry more local stations and for systems in excess of 24 channels, that proportion is always greater than one-half.

TABLE 1

PROJECTED CABLE CARRIAGE OF LOCAL BROADCAST STATIONS, BY CHANNEL UTILIZATION
(Number of Satellite Services = 45)

Number of Independents	Total Stations Available 1/	Number of Channels Utilized 13	24	35	50
		Projected Number of Stations Carried			
1	4	3.16	3.42	3.61	3.78
2	5	3.66	4.05	4.36	4.63
3	6	4.01	4.55	4.99	5.41
4	7	4.15	4.86	5.47	6.08
5	8	4.11	4.99	5.78	6.62
6	9	3.91	4.93	5.90	7.00
Number of Duplicate Affiliates					
1	4	3.23	3.47	3.64	3.80
2	5	3.86	4.21	4.47	4.70
3	6	4.40	4.87	5.23	5.72
Three Independents, Two Duplicate Affiliates	8	4.53	5.38	6.10	6.85

1/ All markets are assumed to have three unduplicated affiliates.

Source: Derived from estimates in Appendix B.

Based on the SMATV analysis, and because cable systems have been growing in capacity over time,[24] we predict that absent a must-carry rule, more than half of the local stations would be carried on cable and, in most instances, the proportion could be expected to exceed one-half by a large margin.

In addition to suggesting that cable systems would tend to carry most local stations in the absence of a must-carry rule, our statistical analysis may also indicate the sensitivity of such carriage to the availability of satellite programming services. In particular, it may be that an increase in the number of satellite programming alternatives increases the likelihood that some satellite alternatives are more profitable to carry than local broadcast stations. As a consequence, in the absence of a must-carry rule, cable systems may tend to carry fewer local broadcast stations.

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[24] In 1980, 358 systems (8.6 percent of all systems) had a capacity of 30 or more channels. (Television and Cable Factbook, 1981). In 1985, 2455 systems (41.7 percent of all systems) had a capacity of 30 or more channels, accounting for 64 percent of all cable subscribers. (Television and Cable Factbook, 1985.)

TABLE 2

PROJECTED CABLE CARRIAGE OF LOCAL BROADCAST STATIONS,
BY NUMBER OF AVAILABLE SATELLITE SERVICES
(Channel Capacity = 24)

Number of Independents	Total Stations Available 1/	Number of Available Satellite Services: 0	35	40	45	50
		Projected Number of Stations Carried				
1	4	3.99	3.78	3.64	3.42	3.10
2	5	4.99	4.63	4.40	4.05	3.57
3	6	5.98	5.41	5.06	4.55	3.88
4	7	6.98	6.09	5.58	4.86	4.00
5	8	7.96	6.64	5.92	4.99	3.94
6	9	8.94	7.03	6.07	4.93	3.72
Number of Duplicate Affiliates						
1	4	3.99	3.80	3.67	3.47	3.17
2	5	4.99	4.70	4.51	4.21	3.78
3	6	5.99	5.56	5.28	4.87	4.29
Three Independents, Two Duplicate Affiliates	8	7.97	6.86	6.23	5.38	4.35

1/ All markets are assumed to have three unduplicated affiliates.

Source: Derived from estimates in Appendix B.

Assuming a 24-channel SMATV system, Table 2 illustrates the change in the number of local stations carried as the number of available satellite services grows.[25] As in Table 1, for any given number of satellite services available, the number of local stations carried by SMATVs tends to increase as the number of stations available increases.[26]

However, as the number of satellite services increases, SMATVs tend to carry fewer local stations. For example, with seven local stations (four independents available), the SMATV will carry about six stations when 35 satellite services are available. When the number of satellite services increases to 45, the number of local stations carried declines to fewer than five. Thus a 29 percent increase in satellite services leads to a 20 percent reduction in the number of local stations carried in this particular case.

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[25] The results in Table 2 should be considered illustrative only. As the total number of programming services (satellite services plus local broadcast stations) increases, we would anticipate that a profit-maximizing cable operator will increase the channel capacity of the cable system. The increased channel capacity will tend to reduce the effects of the increased availability of satellite services on the number of local broadcast stations. The effect here is similar to the discussion in the text surrounding Table 1.

[26] Of particular interest is the case in which the number of satellite services is zero. In that instance, virtually all local broadcast stations are carried in every situation considered. This is probably a very good approximation to that point in time when cable was primarily a retransmitter of broadcast signals. Had we instead found that few if any local stations would be carried in these circumstances, considerable doubt would have been cast upon the validity of our results.

In addition, when the number of satellite services increases, SMATVs tend to add fewer local stations as the number of available stations increases. For example, consider a situation in which the number of local stations increases from five (two independents) to seven (four independents). When there are 35 satellite services available, the SMATV will carry an additional 1.5 stations. If there are 45 services available, the increased carriage amounts to less than one station.

These results suggest that the availability of satellite programming services does reduce the number of stations carried, particularly when compared to that period in cable's history when only broadcast stations were carried by cable. Thus, if one seeks to explain a must-carry rule in rent-seeking terms, the broadcasters clearly gain from the guaranteed access to cable systems provided by an effective must-carry rule. That guaranteed access affords broadcasters some protection from the competitive threat posed by satellite programming services. As a result of the rule, fewer satellite services will be provided to subscribers and/or the price charged cable subscribers will he higher than otherwise. Consequently, there will be fewer cable subscribers and more consumers will devote a greater amount of their viewing to over-the-air television than would be true in the absence of the rule.

D. Conclusion

The analysis presented here is subject to a number of caveats previously discussed. Nonetheless, the experience of SMATVs does suggest that if SMATVs and cable are economically analogous, unregulated cable systems can be expected to carry many or most local broadcast stations.

If SMATV is considered more competitive than cable, then this analysis provides the basis for an alternative to the adoption of an inflexible rule that by its nature ignores wide variations in market characteristics. The analysis could be used to determine the must-carry requirements of cable in different market environments, requirements that could be rebuttable by cable operators.

In either case whether First Amendment concerns should dictate greater carriage than that which a SMATV (or an economically analogous cable system) would provide must be weighed against the costs of such a policy, including the inhibitory effects of such a policy on the development of alternative satellite services. Because SMATVs carry a high proportion of local broadcast stations, the net consumer benefits from any additional required carriage are likely to be small or

negative or equivalently, the First Amendment harm to the broadcasting system in the absence of a rule is likely small.[27]

Finally, the availability of additional satellite programming services has a small but noticeable effect on the number of broadcast stations carried. Thus it is perhaps not surprising that broadcasters have fought so hard to retain the competitive insulation from satellite programming services that the must-carry rule provides. The welfare-maximizing policymaker must decide the extent to which the First Amendment concern raised by broadcasters for the retention of rule is merely a regulatory shield protecting broadcasters from competition.

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[27] If those few stations not carried by a cable system believe that the denial of cable carriage represents anticompetitive exclusion, those stations can seek redress not only through the antitrust laws but also through the "commercial use" or "leased access" provisions of the 1984 Cable Communications Act, 47 U.S.C. Section 612 (1984). Under the Act, cable systems with 36 or more channels must set aside a specified percentage of those channels for "commercial use" by programmers not affiliated with the cable system. If a programmer has not been "selected" by the cable operator for carriage, that programmer can invoke the leased access provisions to obtain cable carriage. While the terms of carriage are initially set by the cable operator, these terms can be reviewed by the courts for "reasonableness." Because of the existence of these leased access provisions, the benefits of a must-carry rule are surely reduced.

APPENDIX A

SMATV Carriage of Local Television Stations

Assume arguendo that the profitability of carrying satellite programming services and local broadcast stations is randomly distributed. For example, if the SMATV operator can select from among 45 satellite services and five local broadcast stations, the top 10 most profitable services might include one broadcast station; the top 20, two stations; and so forth. If this is true, then any collection of satellite and local broadcast programming services offered by SMATVs to subscribers should contain (approximately) the same proportion of local stations as exists in the entire array of programming services--the sum of satellite and local broadcast services--available to SMATVs. However, the limited number of channels offered by SMATVs in our data set suggests that if in fact the profitability of carrying local off-airs tends to rank in the middle or towards the bottom of the programming array, we should observe a very low proportion of channels devoted to off-air stations. Alternatively, if the profitability of carriage of local stations tends to rank high in the programming array, we should observe a high proportion of channels devoted to off-airs, as compared to the hypothesis that programming profitability is random.

Table A1 presents the results of our inquiry. In almost every case the proportion of SMATV channels devoted to local stations tends to be considerably higher than the proportion of off-airs in total programming services available, and for the

TABLE A1

TENDENCY OF SMATVs TO CARRY LOCAL TELEVISION STATIONS

SMATV Location	P1 1/	P2 2/	Probability of P1 Occurring by Chance 3/
Philadelphia, PA	.56	.21	Less than .0002
Austin, TX	.50	.12	Less than .0002
Miami, FL	.67	.24	Less than .0002
Austin, TX	.38	.12	Less than .001
Salt Lake City, UT	.50	.12	Less than .0002
Murray, UT	.50	.12	Less than .0002
Denver, CO	.58	.17	Less than .0002
Denver, CO	.64	.17	Less than .0003
Aurora, CO	.50	.16	Less than .001
Ypsalanti, MI	.40	.29	.14
Nashville, TN	.45	.11	Less than .0002
Oklahoma City, OK	.34	.15	.03
Tulsa, OK	.34	.11	.009
Little Rock, AK	.34	.11	.009
Memphis, TN	.34	.15	.006
Sacramento, CA	.50	.21	.024
Apache Wells, AZ	.38	.18	.0023
Indianapolis, IN	.38	.12	Less than .0003
Kalamazoo, MI	.60	.14	.0099
Scottsdale, AZ	.44	.16	.0039
Scottsdale, AZ	.45	.16	.05
Cincinnati, OH	.38	.23	.05
Phoenix, AZ	.50	.14	Less than .0002
Dallas, TX	.46	.18	.0036
AVERAGE	.46	.16	.001

1/ P1 is the proportion of the SMATV's channels devoted to local television stations.

2/ P2 is the population proportion of total available programming services (the sum of the total number of satellite services available on all satellites plus the number of local broadcast stations) accounted for by local TV stations. A TV station was considered local if the stations's grade B contour encompassed the SMATV community.

3/ The lowest value that could appear in this column is zero while the highest value is one. A value of zero would indicate that the chance of observing a value at least as large as P1 if the population proportion is P2 (i.e., if in fact the profitability of local broadcast and satellite programming is randomly distributed) is virtually impossible. Technically, the population proportion will be distributed normally with mean P2 and variance . In calculating the probability of deriving a sample proportion at least as great as P1 from the underlying population, we used standardized normal variates. See Thomas H. Wonnacott and Ronald J. Wonnacott, Introductory Statistics (New York: John Wiley and Sons, 1977) at 166-170.

Source: SMATV data were derived from the SMATV Newsletter (Paul Kagan and Associates), various issues from 1981-1985. Grade B data were compiled from The 1984 Cable TV Coverage Atlas and the 1984 Television and Cable Factbook, Stations volume. Stations not operating at the time of the SMATV observation were excluded from the calculation. The number of video satellite programming services was derived from the Satellite Services Report, (National Cable Television Association), various issues from 1981 to 1985.

entire sample, the SMATV proportion is nearly one-half. Equally important is the fact that the possibility of these SMATV proportions being derived from an array of programming where profitability is randomly distributed is soundly rejected.[40] In the worst-case, the probability of the proportion for the Ypsalanti SMATV system occurring if programming profitability were randomly distributed is only 14 percent. For the sample as a whole, the probability is about one in a thousand. It seems clear, then, that SMATV carriage of local broadcast stations tends to be more profitable than the carriage of satellite programming services. The conclusion which follows is straightforward: the Commission should expect cable to exhibit this same strong tendency to carry local stations in the absence of a must-carry rule.

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[40] In other words, if the profitability of carrying either a local broadcast or a satellite service is randomly distributed, the number of local stations carried by the SMATV, as a proportion (P1 in Table A1) of the sum of all satellite and local broadcast services carried should be statistically close to P2 in Table A1. The greater is the difference between P1 and P2, the less likely it is that the selection of services offered by a SMATV can be considered a "sample" from a population of broadcast and satellite services whose carriage profitability is random. Because P2 follows a normal probability distribution, we can calculate the probability that the "sample" P1 was in fact drawn from such a population. See the notes to Table A1.

APPENDIX B

Introduction and Hypothesis

The results reported in the text are based upon relatively straight-forward reduced form estimation. We first attempted to explain the total number of local stations carried by a SMATV system as a function of the number of channels used by the SMATV and the number and characteristics of the local broadcast stations available off-air. However, application of ordinary least squares may generate estimates of the number of stations carried that exceed the number of available stations or are negative. Consequently, with the aid of logit techniques we instead substituted as the equation's dependent variable the proportion of local stations carried by SMATV systems. These techniques guarantee that the estimated proportion will never be negative or exceed one.

The hypotheses tested are described in the text, while the source of our data can be found in Table A1. A primary focus of our empirical exercise was the effect of various kinds of local broadcast stations on the proportion of local stations carried by a SMATV. Virtually every study of which we are aware that has examined relationships involving broadcast stations or cable systems--particularly cable demand studies--has found important differences across various station categories.[41] These differences

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[41] See notes 42 and 43.

are typically attributed to technical and economic distinctions among various station categories.

For example, because of the cost economies television networks experience in the production and distribution of programming and the sale of advertising, network affiliates typically carry the most expensive broadcast programming. The presumable popularity of these programs suggest the profitability of cable carriage of an affiliate of each network. Moreover, carriage of duplicate affiliates may be profitable because of non-network programming; networks tend to affiliate with those local stations that have more attractive non-network fare such as local news and sports.

Independent commercial stations must either produce all their programs, rely on nationally distributed programs that tend to be less expensive and less popular than first-run network programs (because all the network economies are not available to them), or rely on previously exhibited network programs (i.e., re-runs). Thus, the programming of independents tends to be less costly and of lower quality than network programs. Consequently, cable or SMATV carriage of independent stations may not be as profitable as carriage of unduplicated network affiliates.

Within the class of independent stations, there may be differences between UHF and VHF stations. Typically, the reception area of a UHF station is smaller than that of a VHF station. For any particular program, a VHF station will have more viewers and thus earn greater advertising revenues than a UHF station. As a consequence, the VHF independent will always

be able to outbid the UHF independent for the program rights. Thus, UHF independents tend to exhibit less popular programs than VHF independents.

However, in those markets where no VHF independent is available (i.e., where only UHF independents are operational), UHF independents will not labor under this bidding handicap. Thus, in such markets, the profitability of cable or SMATV carriage of UHF independents may be higher than is the case where VHF independents do exist.

The final station category is educational. Although educational stations tend to capture lower viewership shares than other stations because of their highly specialized programming, cable or SMATV subscribers may be willing to pay a relatively higher price to obtain this programming.

Our prediction regarding the ranking of these various kinds of local stations on the SMATV proportion of local stations carried is based upon existing empirical evidence. For example, a seminal cable demand study found that carriage of unduplicated affiliates had the greatest impact on cable demand.[42] Carriage of educational stations and duplicate affiliates have similar but far lower demand effects than that for unduplicated affiliates. Independent stations have the smallest demand effect, with VHF independents having a larger impact than UHF stations. While confirming the impact of unduplicated affiliates on cable demand,

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42 R. Park, "Prospects for Cable in the 100 Largest Television Markets," Bell Journal of Economics, Vol. 3, No. 1 (Spring 1972), equation (*), Table 2 at 139.

a more recent cable demand study finds no effect of carriage of educational stations on cable demand and finds a reversal in the ranking of duplicate affiliates and independents.[43]

Because all of our SMATV systems have at least three unduplicated affiliates available over-the-air, our empirical analysis of the effect of various station types adopts the presumption, stemming from the available empirical evidence on cable demand, that the proportion of local stations carried by SMATV systems will be greatest when there are only three non-duplicated affiliates available over-the-air. When the number of local stations increases beyond the three unduplicated affiliates, we predict that the proportion of local stations carried by a SMATV will fall (but the number of stations carried will rise). Except for the expectation that the proportion will decline, we are agnostic regarding the rank-order of the effects of station availability by station type.[44] However, the cable demand studies do lend a strong presumption that different station types should have different impacts on the proportion of local stations carried by a SMATV.

Our hypotheses regarding the number of channels used and the number of satellite services available for SMATV carriage are described in the text. We predict that an increase in the number

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[43] K. Dunmore and M. Bykowsky, "Cable Television Demand and its Implications for Cable Copyright" (unpublished draft, July 1982), at 24-25.

[44] Given the results of cable demand studies, we test the null hypothesis that the relevant coefficients are zero against the alternative hypothesis that the coefficients are less than zero.

of channels used will increase the proportion of local stations carried.[45] An increase in the number of satellite programming services from which the SMATV can choose is expected to have a negative impact on local station carriage.

Selection of SMATVs

In choosing SMATV systems to include in our sample, we adopted certain screens. First, as noted in the text, systems that provided subscribers with over-the-air stations via an A/B switch, master antenna, or both were excluded. Thus, the availability of local stations to SMATV subscribers may be understated in our sample. Second, if an operator owned (e.g.) five SMATV systems in a specific community and the SMATV systems looked exactly alike with respect to the number of channels available and the number of off-airs provided, only one of the systems was included in our sample. Our concern, of course, was that our observations would not be independent if all five systems were included. If the commonly-owned SMATV systems were in different communities or were in the same community but differed with respect to either the number of channels available or the number of local stations provided, such systems were included in the sample. Third, there were a few instances in which a number of commonly-controlled SMATV systems in a

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[45] It might be argued that channels used is an endogenous variable, simultaneously determined with the number of local stations carried. This criticism might be particularly apropos if we had estimated the total number of local stations and satellite services carried rather than the proportion of local stations carried. In any event, initial experimentation with two stage least squares failed to improve our results.

particular area were described as having a "typical" configuration of channels and local off-airs offered. We included the "typical" system in our data set. Fourth, there were two instances in which the described number of local stations carried exceeded the number of local stations available. These observations were excluded from our sample. The result of our screens left 24 observations in the data set.

Estimation

The value of our dependent variable of interest, viz., the proportion of local stations carried by a SMATV, occasionally assumes a value of one. As a consequence, strict application of the log-of-the-odds version of logit was inappropriate as were logit software packages that presumed a dichotomous dependent variable (i.e., one that assumed either a value of zero or one). Our adjustment of the dependent variable to take account of the small sample size artificially resolved this issue.[46] However, we also estimated the logit directly using maximum likelihood procedures without the small sample adjustment. The assumed starting value for the parameters in the maximum likelihood procedure were those derived from the log-of-the-odds model with the small-sample adjustment. We compared the two models using

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[46] See R. Pindyck and D. Rubinfeld, Economic Models and Economic Forecasts (New York, NY: McGraw-Hill Book Company, 1981) at 293 (hereafter "Pindyck and Rubinfeld").

the likelihood ratio test.[47] Finally, we adjusted the data for possible heteroscedasticity.[48]

Results

Table B1 defines the variables used in our analysis while Table B2 presents our results. The results of our efforts are generally described in the text. As compared to equation (1), no distinction among the various categories of local stations available was statistically meaningful. However, we nonetheless present these results in light of the cable demand studies indicating that such distinctions are indeed important. We suspect that such a distinction would be apparent in a larger sample size. For equations (1) and (2), use of maximum likelihood procedures did not statistically improve our parameter estimates. For equation (3), however, maximum likelihood estimation did result in improved estimates, reported as equation (4).

Given our failure to distinguish among the various types of stations and because of the cable demand results, our discussion in the text regarding the projected number of stations an unregulated cable system would carry is something of a compromise. We

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[47] See Pindyck and Rubinfeld at 312.

[48] Id. at 293. Because of this adjustment, the "intercept" is no longer estimated by a vector of ones in the data matrix. As a consequence, all regressions were forced through the origin. Because standard alogarithms for calculating the multiple correlation coefficient are inappropriate, in Table B2 we present the simple correlation between the actual and predicted value of the dependent variable.

TABLE B1

VARIABLE DEFINITIONS

Variable	Definitions
P	Proportion of local stations carried by SMATV
CHU	Number of channels provided by SMATV
OFFAIRS	Number of broadcast stations whose Grade B contours encompass the SMATV community (hereinafter referred to as local stations)
IND	Number of local independent broadcast stations
INDVHF	Number of local independent VHF broadcast stations
INDUV	Number of local independent UHF stations in SMATV communities where at least one independent VHF station is operating
INDU	Number of local independent UHF stations in SMATV communities where no independent VHF station is available.
EDU	Number of local educational stations
DUP	Number of local duplicate affiliates
SAT	Number of satellite programming services

TABLE B2

EMPIRICAL RESULTS
(t-statistics in parantheses)

Equation Number	Dependent Variable	CHU	OFFAIRS	INDVHF	INDUV	INDU	IND	EDU	DUP	SAT	INTERCEPT	Simple Correlation
(1)	Log $(\frac{P}{1-P})$	.117* (2.32)	-.265* (4.24)	---	---	---	---	---	---	-.125* (2.59)	6.174* (2.92)	.79* (6.04)
(2)	Log $(\frac{P}{1-P})$	.041 (.55)	---	---	---	---	-.318* (3.61)	.067 (.23)	-.213** (1.66)	-.108** (2.06)	5.974* (2.75)	.76* (5.48)
(3)	Log $(\frac{P}{1-P})$	.052 (.63)	---	-.851** (1.34)	-.244* (1.90)	-.428* (-2.43)	---	.09 (.31)	-.246** (1.68)	-.115** (2.01)	6.413* (2.53)	.82* (6.64)
(4)	P	.076 (.88)	---	-.399 (.63)	-.321* (2.18)	-.374* (2.20)	---	-.014 (.05)	-.235** (1.65)	-.099** (1.88)	5.595* (2.50)	.76* (5.47)

* Significant at 95 percent confidence level or better.

** Significant at 90 percent confidence level.

Note: The alternative hypothesis for each of the station variables is that the parameter estimates are less than zero. For CHU, SAT, and the intercept, the alternative hypothesis is that the coefficients of these variables are not equal to zero.

relied on equation (2). Compared to equation (4) and as judged by the magnitude of the parameter estimates, use of equation (2) will result in somewhat more optimistic projections of the number of independents and duplicate affiliates carried and of the effect of channels used on local station carriage. Equation (2) will also result in a somewhat larger effect of satellite program availability on the number of local stations carried.

However, because statistically we were unable to distinguish either equation (2) or (4) from equation (1), we believe that equation (1) is more relevant for comparison purposes. As compared to equation (1), equation (2) will yield more conservative results for the number independents carried and somewhat more optimistic results for the number of duplicate affiliates carried. The impact of channels used and the number of available satellite services on cable carriage of local stations will tend to be more conservative in equation (2) than equation (1). Thus, in general, we believe our results to err, if at all, on the conservative side.

Finally, the projections described in the text estimate the number of local stations carried as the number of channels used increases. Even though this variable was statistically insignificant in equation (2), its significance in equation (1) suggests that our small sample may be the cause of that insignificance. Thus, we concluded that it was appropriate to use the point estimate of equation (2) for prediction purposes. However, because the maximum number of channels used in our data set is

24, our carriage projections for systems with in excess of 24 channels should be considered only as a rough order of magnitude.

In equation (2), the coefficient estimate for the number of educational channels is positive but statistically insignificant. One interpretation is that the number of educational stations has no impact on the proportion of local stations carried by a SMATV. While this could be true, we thought the more prudent course was to avoid using equation (2) to predict carriage of educational stations. We did attempt to isolate those circumstances in which only one educational station was available from those in which more than one were available. Such a dichotomy would have permitted us to examine of differential effects in the availability of an unduplicated educational station and of duplicate educational stations on on SMATV carriage of local broadcast stations. However, we found no statistically meaningful distinction.

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THE CABLE ACT REVISITED -- THE PUBLIC INTEREST VS. THE CABLE MONOPOLY

A WHITE PAPER

By

Nicholas P. Miller

July 23, 1987

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THE CABLE ACT REVISITED -- THE PUBLIC INTEREST VS. THE CABLE MONOPOLY

I. Introduction

The Cable Communications Policy Act of 1984 (PL 98-549, 47 U.S.C. §521, et. seq.) was passed in the last days of the 98th Congress. There are many positive aspects of the Act. However, two years of experience have shown that the Act has several obvious flaws. The Act falls far short of protecting consumers, programmers and would-be competitors from the cable monopoly. And time has illustrated that the cable industry is not respecting the fundamental legislative agreements between franchising authorities and cable operators which the Act was intended to embody.

With the clarity of hindsight, and a shifting political scene at the national level, it is time to ask Congress to revisit the Cable Act and to make substantive modifications to it. This paper describes the relevant, but unreported, legislative history of the Cable Act, the agreement that the cities thought they had, and the necessary changes that are required to the Cable Act in order to make the 1984 agreement work as it was intended.

Nicholas P. Miller is a partner in the law firm of Miller, Young & Holbrooke and represents many different cable franchise authorities, large and small, across the nation. He was a registered lobbyist for the cities' interests in the 1981-84 Congressional debate on cable legislation. Based on this experience, the author draws the conclusions embodied in this paper. However, no official representative or association of local franchising authorities has publicly endorsed the points in this paper. The conclusions are solely those of the author.

II. The Cities and Consensus on Cable Regulation

Cities and local franchising authorities do not speak with a monolithic voice in cable television matters. There are over 7,000 local cable television franchises issued in more than 20,000 communities in the United States today. In any one year, no more than ten percent experience one or another form of significant cable activity such as renewal, litigation, or major service revision. Typically, cable television regulation is dormant in the remainder. As a result, there will always be a vocal, but minority, number of municipalities ready to speak out on cable matters. The vast majority will be silent unless prodded. The silence is not opposition to the vocal communities. Rather, it is a lack of urgency in the silent communities. But, just as night follows day, every city with a cable franchise, over the normal course of the life of that franchise, will have similar problems. So in 1988, 700 to 1,000 communities may face cable television controversies. In 1991 a different 700 to 1,000 communities will have the same troubles. The cities intuitively understand this and are capable of moving in unison. But the political lead will inevitably fall to those interest groups and communities faced with the problems today.

III. Some Unreported Legislative History

Much of the important legislative history surrounding the Cable Act in 1984 has never been reported. The Act was a product of the convergence of accidental historical forces which

permitted the bill to become law. The cable industry took advantage of an historic window of opportunity which was open for only a few months.

Prior to 1980, cable regulation was dominated by local municipalities, acting under guidance from the Federal Communications Commission, which in turn was sensitive to the needs and desires of programmers carried on cable systems, such as local broadcasters, public access users, and program syndicators. The world changed in 1981-1982. By 1983, several members of Congress were persuaded that cable had been unfairly regulated and retarded in its development through federal and local regulations hampering its profitability. The cable industry turned this sympathy to its advantage and asked Congress for total protection from its potential competitors and its regulators. Simultaneously, the Mark Fowler FCC and the Reagan Justice Department concluded "marketplace forces" would be adequate to discipline cable operators' behavior and that local cable franchise regulation should be preempted and eliminated wherever possible.

During these same years, three long-time opponents of the cable industry were seriously distracted, leaving the cities isolated and alone in resisting cable deregulation. AT&T and the rest of the telephone industry were caught in the politics of divestiture and national legislative proposals for massive restructuring of basic telephone service. The competitive opportunity of offering cable television service, while

significant, did not appear as a large enough blip on the radar scope to warrant reorientation of the telephone industry's defensive armament. The program syndicators, in particular the Motion Picture Association of America and its members, were caught up in the Betamax dispute in Congress and the copyright allocation arguments in Congress and at the Copyright Royalty Tribunal. And the local broadcasters were stymied by the promise of a "deregulatory millennium" at the Fowler FCC. Neither the National Association of Broadcasters (NAB) nor the Association of Independent Television Stations (INTV) could challenge the FCC's deregulation of a fellow communications industry. Those forces combined effectively to isolate local cable franchising authorities (the cities, counties, and states) as the sole opponents to cable deregulation.

In 1982 - 1983, cable was still a very new concept to most consumers and their local elected officials, particularly in cities. They were unprepared to express strong concerns to Congress on national cable television policy. As recently as 1976, the introduction of satellite movie services created the first economic opportunity for cable to wire the major television markets. The scramble to franchise major metropolitan areas really started only in 1978. The cable industry used that local ignorance to make exaggerated promises to uninitiated local elected authorities that cable would bring diversity of viewpoints, economic development, and competition to the telephone and broadcast industries. Time would prove the cable

industry had no intentions of delivering on its promises. A similar local political scenario developed in city after city. The FCC had prohibited cash auctions of cable franchises which would have recaptured for the taxpayer expected cable monopoly profits. So cities solicited open bid competitions. Cable operators responded with expensive, competitive bids hoping to be awarded what everyone anticipated would be de facto monopoly franchises, given the natural monopoly characteristics of cable television systems. These competitive franchise bids promised much in technological and service innovations. But the ink was not dry on most franchise awards before the successful bidders started poor-mouthing the business and seeking relief from their promises.

The franchise areas licensed in the 1978 - 1982 period were so enormous that each system required four to six years to build. As a result, by 1983 - 1984, most of the major metropolitan areas had issued cable franchises, but very few had yet experienced cable service. Franchise fees and local programming services had not yet created a core professional staff within the cities nor a day-to-day constituency demanding performance of the cable operator's franchise promises. In addition, the cable systems franchised in the early 1970s, prior to the advent of satellite movie services, were all coming up for renewal in the late 1980s. As many as 500 or 600 systems per year were scheduled for renewal. The cable industry saw the chance to load the dice on the outcome of those renewal decisions.

Today, the political landscape looks entirely different. The bloom is off the Fowler rose of cable deregulation, significant changes have occurred in attitudes of Senators and Representatives serving on the Congressional committees and subcommittees controlling cable television policy. The large metropolitan areas are approaching 60% to 70% completion of their cable builds and now understand the nature and potential for cable television technology. The telephone industry is on a relatively certain regulatory path. And Hollywood and the broadcasters most dependent upon cable to reach viewers now recognize the threat they face from an unregulated monopoly which is also the electronic gatekeeper to the nation's television sets.

Given the politics of 1983 - 1984, it is remarkable that the cities achieved any success in the Cable Act of 1984. In fact, the cities were able, largely due to the leadership of the National League of Cities and U.S. Conference of Mayors, to bring political forces to bear that created a legislative stalemate in the House of Representatives and forced negotiations between the cable industry and the cities to work out the details of the Cable Act.

IV. The 1984 Deal

The final negotiated deal embodied in the 1984 Cable Act had three specific legs. First, the cities insisted upon and thought they had achieved clear federal recognition of the legal right of

local franchise authorities to be the primary regulators of cable television. Second, there was an explicit political trade of rate deregulation in those markets where cable was "subject to effective competition" in exchange for the cable industry's recognition that the cable franchise contracts signed prior to 1984 were fully enforceable and "grandfathered." Third, the renewal issue was compromised. The cities accepted a set of specific, formal renewal procedures which the incumbent operator could invoke to ensure fair consideration at the time of renewal. Simultaneously, the cities thought the deal provided that the incumbent cable operator could not claim any substantive right or expectation of renewal.

This deal, in broad outline, appears to continue to represent a consensus among the cities as to appropriate national cable television policy.

V. The Rising Dissatisfaction With the Cable Act Within the Municipal Community

Almost immediately after enactment of the 1984 Cable Act, individual cable companies began probing and testing the outer limits of the legislative language. Over the course of the last two years, a combination of aggressive First Amendment lawsuits brought by cable companies in federal courts, overreaching "applications to modify" existing franchises, and the Fowler Commission's overbroad interpretations of the FCC's prerogatives under the Cable Act have challenged the fundamental deal the cities thought they had struck in 1984. Instead of a period of

peace and cooperation, the Act has stimulated a number of contentious, expensive, and fundamental litigation challenges to the Cable Act compromise.

The cities have watched with dismay as the FCC defined all cable companies as "subject to effective competition" free of any rate oversight, defined all "basic" services as subject to unrestricted retiering, and claimed that the Cable Act gives the FCC broad powers to preempt all forms of city regulation of cable. The U.S. Court of Appeals for the District of Columbia has had to reverse the FCC on each of these points. The FCC, to date, has yet to revise its earlier rulings. Simultaneously, enormous and expensive administrative hearings threaten to arise in many cities as the late 1980s renewals begin and cities face the complex administrative proceedings specified in the Act with little hope of finally resolving the legal claims of the incumbent cable operators.

And finally, led by a strident minority within the cable industry, a number of First Amendment lawsuits to all forms of municipal regulation of cable are slowly winding their way through the courts. These cases challenge refusals to issue one or more franchises, challenge requirements for leased and public access channel capacity, challenge franchise fees and franchise requirements to support public access services and claim that, once franchised, an incumbent cable operator cannot be evicted.

the enormous electronic editorial control that the local cable operator asserts over televisions in the community. Local elected officials can be expected to reflect this public awakening as voters ask them to reassert their prerogatives in issues such as channel realignment and service deletion.

VII. Suggested Changes to the Cable Act

This list of legislative ideas is organized along the lines of the original "deal".

I. Clarify the cable regulatory powers of local authorities versus the FCC.

   A. Make clear local authorities have the primary responsibility to regulate cable and to establish all standards for the local cable television company, including

      1. The definition of what services constitute the basic tier of service;

      2. The applicable technical and operational standards for signal quality, hardware requirements and consumer protection;

      3. Retiering of services and changes in channel alignment.

   B. Deny FCC authority to preempt except where otherwise explicitly ordered.

II. Implement rate deregulation only as intended in the Cable Act of 1984.

   A. Congress should define "effective competition".

   B. Permit local authorities to require a "basic tier of services" which would include must-carry, leased and PEG access channels.

VI. The Politics Supporting a Legislative Initiative to Revisit the Cable Act

The public's consciousness is awakening. Recent rate increases, retiering and channel realignments by cable operators have illustrated that traditional regulatory remedies have been taken away from local officials and no consumer recourse substituted. Several major metropolitan areas with franchises worth hundreds of millions of dollars have been stunned as their local cable operators simply ignore or pretend that there are no legal teeth in the local franchise.

A classic case is Montgomery County, Maryland. In that instance, Tribune-United built one-third of the promised system, then stopped all construction and sought the protection of the Cable Act to frustrate local contract enforcement efforts.

Overall, public pressure for change seems to be building. The public's perception of cable has changed as a majority of television homes are now passed by a cable company's wires. The industry has been trying to lower public expectations of program diversity, signal quality, and new service possibilities at the very time subscribers are anticipating increased television choices over cable via satellite, local broadcasting, local access and municipal programming services. A subtle shift is occurring in consumer perception. The public expects cable operators to be service oriented, utility-type businesses in the local community. Voters appear short-tempered and intolerant of cable company excuses for poor signal quality, high prices, and unresponsive service. And the public is beginning to understand

III. Restate the enforceability of existing franchises.

A. Allow the full enforceability of franchise promises during the pendency of any modification or renewal proceeding.

B. Allow local authorities to terminate an operator in the event of material breach or failure to renew, and state clearly a city's right to buy the system upon termination.

C. Insulate the franchising authority from damages liability in the event it enforces, terminates, or otherwise acts in reasonable reliance upon the existing state of the law.

IV. Remove any question of a substantive right to renewal.

A. State explicitly that the incumbent operator has no legal expectancy of renewal.

B. Eliminate the substantive tests for nonrenewal contained within the current procedural provisions.

C. Eliminate or simplify the requirement of a formal administrative hearing.

D. Clarify that a purchaser of the system must correct the failings of the seller to avoid responsibility for those problems at time of renewal.

V. Other significant issues need to be revisited.

A. Eliminate the must-carry sunset.

B. The definition of franchise fees needs to be clarified to remove the implication that "in-kind support" may be a potential offset against the franchise fee ceiling.

C. Concentration of cable system ownership is a valid concern for local authorities. Franchising authorities should be able to consider local media concentration questions in reviewing the qualifications of a proposed franchisee.

D. Telephone companies should be permitted to offer cable services.

E. Cable operators should be required to offer leased access channels under "nondiscriminatory" rates,terms and conditions.

F. Allow rate regulation of access channels and programming.

G. Petitions by the cable operator challenging franchise authority review of modifications should not be subject to de novo court review.

H. Franchises should be fully enforceable with respect to all of the services promised except in the case of "commercial impracticability."

I. Franchising authorities and access representatives should enjoy the same immunity from liability for slander and liable as cable operators for the content of access programming.

VI. Clarify the right to award franchises.

A. Franchising authorities should have the explicit right to issue 0, 1, or more franchises, free of any legal risks, provided their action is not arbitrary or capricious.

B. Cities should have the right to issue and to renew cable franchises through cash auctions or through hardware and facilities auctions as they deem appropriate.

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Franchise Overbuilds - The Cable Industry's Challenge

by

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Washington, D.C.

before the

15th Annual Telecommunications Policy Research Conference

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In this era of concern for plagiarism, let me assure you that the remarks I will make today are not a repeat of anyone else's. But they are a reformulation of my own remarks on this topic before the Great Lakes Cable Expo last week. I also, like Judge Bork, want the right to contend at some future time that these were merely academic musings, and not my real opinions.

Overbuilds are truly a hot topic - even the Wall Street Journal made it a page one story two weeks ago. But is all the hysteria really justified? In reality the overbuild activity at the moment is largely confined to two states, California and Florida. Only one-half of one percent of the cable systems in the United States face an overbuild today.

But California and Florida are bellwether states, and the success or failure of overbuilders there is likely to have a spillover effect. So I will spend some time today giving an overview of just what is happening in these two states. Then I will try to put these events in a broader context, and suggest some credible lines that could be drawn by municipalities, courts or legislatures for rational conditions on unchecked overbuilding activity by any and all potential entrants.

I also believe the overbuild phenomenon has a positive side for the cable industry, in the much broader complex of issues in which it is now engaged. The overbuild activity and current decisions have to take the wind out of charges by the movie industry, by some broadcasters and by some cities advocates that cable is an unrestricted monopoly and should therefore lose its compulsory license, have rate regulation and channel carriage rules reimposed by new legislation and new rules added to limit MSO concentration and vertical integration of MSOs with programmers. How to deal with overbuilding is a dilemma for both cable and its current adversaries on these issues.

The California cable cases have been the most visible the past few weeks. It seems like I no sooner get out a notice to all my clients about one First Amendment franchising case than another one pops out. In fact, three major federal court decisions have come from the state that brought us Preferred within the space of a month. The first, the Pacific West Sacramento case, in mid-August, followed an extensive jury trial on the issue of whether cable was a "natural monopoly". Before cable audiences I have to try to define what economists mean by a "natural monopoly". But you in this audience know it better than I do. A "natural monopoly" is an industry where

free marketplace competition would inevitably result in a single firm controlling the market in that community, such as local electrical power.

As Judge Milton Schwartz said in the Sacramento case, where you have "natural monopoly", the public might benefit through lack of wasted resources, and by gaining certain quid pro quo commitments, "by designating the monopolist at the outset." But the judge held the city had not proved to the jury that cable in Sacramento was a natural monopoly. Although Sacramento had significant governmental interests in technical and financial standards, access channels, and uniform service throughout the community, these could be required of all franchise applicants, not just one of them selected by the city in a bidding process.

In fact, right after the jury had originally reported its rulings, the city, on July 6, threw in the towel and adopted a routine licensing process for new franchises. All it now requires is a performance bond, a 5% franchise fee, six access channels, and 450 MHz of capacity. A new applicant can self-select the boundaries of whatever franchise area it chooses. The last point was most frightening both to Scripps Howard, the existing Sacramento franchisee, and to other cable

operators. If cream-skimming were to be officially sanctioned, then the first franchisee, which had already built almost the entire city, would be at a substantial disadvantage. Scripps-Howard has sued the city's cable commission, making this point.

The next California case, the Century Federal Palo Alto case, and was decided at the beginning of September. This time, the overbuild applicant had already invalidated the city's single franchise policy last December. The court ruling also held unconstitutional all of the usual types of franchise conditions set by cities, such as access channels, state of the art technology, and even universal service.

Judge Eugene Lynch found cable operators to be almost precisely the same as newspapers for First Amendment purposes. Just as a newspaper cannot be told what articles to carry, cable could not be told what channels to carry. Since cities could not order newspapers to deliver to a particular geographic area of a community, they could not order cable to do so.

Judge Lynch asked for further briefings on franchise fees. He did not seem to buy the argument that cable operators and theorists have advanced that any fee beyond cost of

regulation would be an unconstitutional tax on cable. He cited a case upholding a city transit authority's revenue raising fee on newspaper vending machines in commuter train stations. He noted that a Pennsylvania federal judge earlier this year upheld a 5% franchise fee in Erie, as based on a "fair rental value of the property interest" in city streets and conduits that a cable operator received with the franchise.

The Palo Alto case is the one the Wall Street Journal editorialized about two weeks ago advising cable operators to embrace it. But the court's invalidation of any "universal service" build-out requirement for cable's competitors is a legitimate concern to existing operators who have been forced to play under different rules. And Judge Lynch's decision on this point is in direct conflict with Judge Schwartz's views in the Sacramento case. Judge Schwartz endorsed universal service as the "most substantial" of all of the legitimate municipal interests in franchising that had been identified by the jury in that case. This conflict between two judges in the same judicial circuit will have to be resolved at a higher level.

The last of the three California cases, Group W Cable v. Santa Cruz, was decided less than three weeks ago, on September 10. This case is also a "good news - bad news" decision for

cable. It did bring comfort to cable operators faced with a hostile city cable commission at franchise renewal. Group W, the existing cable operator, had been displaced by the city in favor of a new RFP process. But federal Judge William Schwarzer, in granting Group W a permanent injunction against displacement, in this case went further than either of his two fellow California judges. These judges seem to be having a competition to see who is more of a First Amendment purist when it comes to cable.

Judge Schwarzer found that as a matter of law a city could never use the "natural monopoly" theory to deny a franchise, even if the facts had been shown at trial -- in Sacramento, for example -- that a "natural monopoly" did exist in a particular community. He noted that the Supreme Court had in the 1974 Tornillo case rejected the "natural monopoly" theory as a legitimate ground for regulating newspapers in striking down a Florida right of reply statute. If cable is like a newspaper, Santa Cruz could not use this ground to regulate cable either. "Economic efficiency," he held, is not a proper ground for municipal regulation of speech. Only if the city could show that its legitimate interest in public safety and avoidance of disruption would be triggered by two or

more franchises in the community could it choose between them. Like the Palo Alto judge, he also threw out most of the city's franchise conditions, except for franchise fees.

Moving to Florida, where there are fewer fully litigated cases or court opinions, cable operators face an even more serious problem. This is the entry of Telesat, a subsidiary of Florida Power and Light, which traditional cable operators accuse of using cross subsidized utility profits from Florida ratepayers to "cherry pick" lucrative private developments in their franchise areas. Several local franchise operators have sued Telesat to prevent it from tying up developments with exclusive contracts and lock out the initially franchised operators, and sued cities that have granted franchises that allow wiring only a portion of a franchise area.

This explosion of litigation, most of it coming just in the past half this year, led to a successful legislative effort on the part of the Florida cable association.

First, the governor signed into law in June a measure that requires any new cable operator entering an area already served by an existing operator to meet identical terms and conditions, including universal service build out requirements, as the existing operator. Another bill passed later bars any

state utilities that own cable subsidiaries from giving them any preferential treatment in pole rates or easements. Both laws go into effect this week, thus there has as yet been no direct challenge to their enforcement.

The Florida and California franchise litigation is not the only action in town. Still pending is the final decision in the 8th Circuit's Nor-West St. Paul case, which pits Continental against a potential overbuilder. Trial will begin soon in that case and may provide yet another approach to the "natural monopoly" issue. The Sixth Circuit may get the Detroit antitrust and First Amendment case brought by CCI against the city and the winning bidder. Conflicting rulings by other courts are still possible. Judge Schwarzer noted that his decision that natural monopoly could never be used to block a new cable competitor conflicted with a number of prior court rulings, including the TCI Jefferson City case where a "natural monopoly" was found at trial and the Supreme Court declined to hear and overturn the appeal last spring.

Definitive decisions in this area will have to wait until the Supreme Court speaks again. But I can provide a summary of where we stand legally at this point, and a few predictions.

First, it may be too late to put the basic traditional cable operator overbuild genie totally back in the jar. In the immortal words of Pogo, "We [in the cable industry] have met the enemy and he is us". There will be at least some overbuilds as a result of the emerging First Amendment law in this area. This line of cases will probably ultimately be decided by the Supreme Court in one of two ways:

- Either the "natural monopoly" issue will have to be litigated in each city, and Jefferson City may be found to be different from Sacramento, or

- The court will affirm Judge Schwarzer's opinion in Santa Cruz that the natural monopoly test does not even apply to cable.

The conditions of competition, under which overbuilds will be allowed, are the crucial second generation cases that are now being litigated in California. Will universal service requirements will be allowed to be set by state statutes as in Florida or by local ordinances? The Scripps-Howard Sacramento litigation and similar cases will determine whether the initial operator will be punished for being first.

In my opinion, when the Supreme Court ultimately gets this issue, it may not necessarily side with the First Amendment purists like the Palo Alto judge. As you recall, the Supreme Court was not quite certain in Preferred whether to accord cable full newspaper-like status, and seemed to hint that cable's eventual First Amendment status would be a distinctive one. I do not believe that the current Supreme Court, with or without the addition of Judge Bork, will totally ignore the claims of municipalities that the "cherry picking" of affluent developments harms their legitimate interests in citizen welfare. While Judge Bork was a member of the panel that struck down the must-carry rules as unconstitutional infringements on cable operators' editorial rights, that decision did so under a balancing test that accorded significant weight to governmental interests.

As for other franchise issues beyond universal service, the fate of access channels is in conflict between the Palo Alto and Santa Cruz decisions which find them unconstitutional, and the Erie case which upheld them. Of all franchise conditions, franchise fees appear to be making the most headway in acceptance by both "liberal" and "conservative" First Amendment decisions so far.

While these battles are important, what is most disturbing to me is the emerging overbuild competition from utilities and by municipalities themselves.

No one can dispute that these utilities really are "natural monopolies". And, as Judge Harold Greene pointed out two weeks ago in continuing to bar the former Bell Telephone Companies from getting into cable and other information services, they are still capable of immense cross-subsidy and actively discriminatory practices. While Judge Greene was talking only about telephone companies, where he felt the FCC's regulatory process was woefully inadequate to catch cross-subsidized competition, many of the points he made apply to utility competition to cable generally.

Cable operators can and probably will have to accept fair competition from other cable operators. In fact some I have spoken with believe that if they continue to provide good service to their customers, rebuild older systems, and maintain good relations with their local municipalities they do not feel threatened by traditional overbuild competition. But the utilities and municipalities are a far difficult breed of competitor. They can use ratepayer and taxpayer funds to

weather many lean years before showing a profit, hanging in for the long term in what would be ruinous overbuild competition for a traditional operator.

Let me give you a few examples of the widespread nature of this phenomenon, beyond the Telesat example:

- AT&T, originator of the "channel lease" business in the 1960's before the Justice Department investigated their efforts to tie up the cable industry and the FCC banned cross-ownership, last week announced that it has re-entered the cable construction business, agreeing to build systems for a large SMATV operator.

- In Springfield, Oregon, INTV contributed $10,000 to a successful ballot campaign this spring that will allow the local electric company to overbuild TCI.

- The FCC is trying to convince Congress to drop the statutory local telephone cable cross-ownership ban that was part of a deal NCTA made with the telephone companies during the 1984 Cable Act negotiations. Several FCC Commissioners have made it clear they want a "one-wire" fiber optic future, and that one wire is <u>not</u> cable's. Why they have given up on two-wire competition, particularly since cable is <u>already</u> a

broadband system, is not clear. The primary barrier to holding back cable's emergence as an interactive voice, data and video medium has been telephone company efforts to block cable entry into these fields at the state PSC level, which the FCC has refused to preempt.

- In Cerritos, California, General Telephone is not subject to the AT&T Consent Decree administered by Judge Greene and, like hundreds of other independent telephone companies, would be free to go directly into cable if the FCC were successful and the Cable Act provision were dropped. GTE is anticipating this possibility. GTE is undertaking in Cerritos a model for cross-subsidized operation, using as its stalking horse an independent cable operator that is leasing one half of a massive bandwidth coaxial system. GTE is leasing the other half to its own research subsidiary. While not an overbuild, this model, if approved, could easily be adapted to this end. NCTA and the California Cable Television Association have petitioned the FCC not to give GTE the necessary authorization to build this system.

- Southern Bell also has two fiber optic experiments with video directly to the home, one with cable only, the other combining video and voice and data.

Added to the prospect of utilities entering the overbuild fray are the growing number of municipalities researching the possibility of getting into cable themselves, or encouraging the entry of utilities. For a municipality to directly run a cable system would be the ultimate affront to the First Amendment. Several California judges identified severe First Amendment problems with the potential for governmental misuse of access channels as a forum for a city's own political views. If a municipality owned the entire system, this danger would be expanded to every channel. Arguably such a system would become a true public forum, like a public park, and no one could be kept off. But with a necessarily finite number of channels, the municipality would be deeply involved in editorial decisions.

The cities are being goaded to act by those who charge that cable has gone back on its commitments in the 1984 Cable Act. These critics, including one of my fellow panelists, claim that cable's First Amendment suits have undermined the Cable Act's approval of access channels and similar franchise commitments, that cable has abused the franchise modification procedure under the Cable Act in cities such as Montgomery County and Austin, and that cable has overreached in gaining a too favorable FCC definition of "effective competition" for purposes of determining which cable operators continue to be rate regulated.

But each of these city complaints is unjustified. The First Amendment suits are clearly not part of a coordinated industry effort, and the results are not universally applauded. In fact, NCTA President Jim Mooney last week offered to back the cities in some of these lawsuits.

Franchise modification requests have not as yet led to favorable final court decisions beyond procedural victories. The Montgomery County case was settled and in Austin ATC has received an initial unfavorable ruling by a retired judge sitting as a trial examiner on the modification request.

Finally, the FCC last week rectified any potential claim of cable industry overreaching by redefining what coverage a broadcast signal needs to have in order to be counted in the "effective competition" rate deregulation test on remand from the D.C. Circuit. The court had agreed with the cities on this point.

Faced with these facts, and the fact of the opening up of cable to competition through judicial decisions, it is incredible that cable critics such as MPAA President Jack Valenti and INTV President Preston Padden are still trying to paint cable as a monopolist on editorial pages and before the Congress.

But it is true that cable will have to decide where to draw the line of battle both in the courtroom and in Congress. If the cable industry is intransigent against any competition, however limited, it runs the risk of validating the worst depictions of its critics in the fight to retain the compulsory license, the Cable Act, and the barrier to direct telephone entry into the cable business. If cable does not, however, oppose unfair competition -- whether by "cherry picking" competitors seeking a quick hit for "greenmail" or for permanent occupation of a lucrative development, or by deep pocket true monopolists supported by utility ratepayers or tax dollars of municipal citizens -- those who have built and invested their talent in this industry run the risk of elimination from it. And this would not be in the public interest, since those entrepreneurs who have brought cable to this point as a vital and creative competitor to broadcasting still have innovative ideas left to give to the public.

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RECENT DEVELOPMENTS IN CABLE LAW: 1987

Alan Ciamporcero, Larrine S. Holbrooke, Nicholas P. Miller

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RECENT DEVELOPMENTS IN CABLE LAW: 1987

Alan Ciamporcero, Larrine S. Holbrooke, Nicholas P. Miller

I. Introduction.

In 1987, several more volleys were fired in the twenty-year battle over regulation of cable television. In Erie, Pennsylvania, a federal judge gave a ringing endorsement of municipal regulation of cable. In Palo Alto and Santa Cruz, California, judges attacked the very basis of local authority to regulate cable and, in Sacramento, a jury found that the franchising process was not warranted by the community's policy goals. Overall, the original and radical notion that the First Amendment prohibits any regulation of cable television made headway in the California federal district courts, but the appellate courts, including the Supreme Court, have yet to speak definitively on the matter. Further, the players who developed the existing national cable policy -- the citizens, municipalities, Congress, the cable programmers, and the cable companies themselves -- are assessing the situation and planning their own next moves.

This paper explains the recent decisions and attempts to put them in perspective. While it might seem as though a revolution has taken place in the courts, it has not. Rather, American institutions are continuing to grapple with the truly revolutionary technology of cable television, a process that is likely to go on far into the future.

II. The Context of the Recent Decisions.

Government involvement in cable television grew out of regulation of broadcasting, the purpose of which was to assure that broadcasting served the public interest. As the Supreme court said in the famous Red Lion case in 1969, "the people as a whole retain their interest in free speech by radio and their collective right to have the medium function consistently with the ends and purposes of the First Amendment. It is the right of the viewers and listeners, not the right of the broadcasters, which is paramount." Red Lion Broadcasting Co., Inc. v. FCC, 395 U.S. 367, 390 (1969).

The impact of cable television on broadcasting increased as the medium became more successful. In the late 1960's, the Federal Communications Commission began to regulate cable to assure that its broadcast policy, encouraging localism and diversity, was not undermined. The Supreme Court approved of certain FCC regulation of cable, and disapproved other regulation. The Court did not permit the FCC to require public access channels in the late 1970's, for example, because Congress had not given the agency authority to establish such rules.

As the FCC drew back from cable regulation, the states and the Congress stepped in. States and municipalities established their own requirements for cable, including access and

institutional requirements, and the courts, for the most part, upheld these requirements. Faced with the possibility of conflicting schemes of regulation, the industry sought national legislation and, with the participation of the cities and states, Congress enacted the Cable Communications Policy Act of 1984 ("Cable Act").

The Cable Act intended to establish a national policy to clarify the system of local, state and Federal regulation of cable television. It affirmed the authority and responsibility of local governments to franchise and to regulate according to local needs, but on the basis of uniform Federal standards. Congress was not overly concerned that this local franchising system, which essentially codified historical practice, would encounter constitutional problems. In fact, it was only the access provisions of the Act that Congress felt required a discussion of constitutional principles, and the Committee Report supplied a strong First Amendment rationale for access.

Since the Cable Act was enacted, the Supreme Court has heard but one case challenging cable regulation on First Amendment grounds. In Los Angeles v. Preferred Communications, Inc., 106 S. Ct. 903 (1986), the Court declined to judge First Amendment challenges to local regulation of cable without "factual information about the nature of cable television." While the Court affirmed an appellate court decision to order a trial to

determine the extent of the cable operator's First Amendment rights (Preferred Communications, Inc. v. Los Angeles, 754 F.2d 1396 (9th Cir. 1984)), it did so on narrow grounds. The Court wanted more facts to determine if cable was "sufficiently analogous to another medium to warrant application of an already existing standard or whether those characteristics require a new analysis." Further, the Court noted that "where speech and conduct are joined in a single course of action, the First Amendment values must be balanced against competing societal interests."

In the wake of the Preferred case, several federal district courts have struggled with the question that the Supreme Court left unanswered. Is cable like broadcasting, like telephony, like newspapers, or is it something altogether new requiring a new legal standard? Regulations aimed not at speech itself, but at the conduct incidental to speech are measured by the constitutional standard taken from United States v. O'Brien, 391 U.S. 367 (1968). To pass the O'Brien test, a government regulation must be content-neutral, that is, it must not be intended to suppress speech. If a cable regulation gets over this hurdle, a court will balance the degree of infringement of the cable operator's First Amendment rights against societal interests in the regulation. It is this balancing act that requires a court to decide whether cable is like broadcasting, or

newspapers, or something new and different. In addition, the fact that cable operators make permanent and exclusive use of valuable public property rights must be factored into the equation.

III. The Recent Decisions.

It is in this context that the recent cable cases must be understood. Lower courts are trying, and will continue to try, to find a First Amendment analysis appropriate to the unique characteristics of cable. In some cases, like Palo Alto and Santa Cruz, the judges will forgo analysis of the cable medium and simply apply the newspaper standard to cable regulation. In others, like the judges in the Erie and Sacramento cases, courts will attempt to understand cable on its own terms, and fashion a fitting legal standard.

1. Erie Telecommunications, Inc. v. City of Erie, 659 F.Supp. 580 (W.D. Pa. 1987).

In this case, an incumbent cable operator challenged fee and access requirements of the franchise on First Amendment grounds, among others. As to the franchise fee, the court first found that there was no evidence that the city's motive was to suppress speech, rather the city simply intended to raise revenue. Because there was no intent to censor, because the city had the clear right to charge a fee for the use of public rights-of-way,

and because the cable business is not protected by the same "nearly absolute strictures against direct governmental regulation" that newspapers are, the court found the franchise fees constitutional.

As to access channel requirements, the court considered both the Supreme Court's views in cases predating the Cable Act, and Congress' opinion expressed in the legislative history of the Cable Act. The court not only found that access regulations were not an attempt to regulate the content of the cable operator's speech, but found that "access requirement further secure the foundation upon which the first amendment is grounded -- promotion of a marketplace of ideas."

Applying the O'Brien balancing test, the court found significant government interests in limiting government intrusion in the public rights-of-way, regulating a natural monopoly, and affording full First Amendment protections to the viewers. Because the government regulations permitted the cable operator to maintain "complete editorial control over a substantial majority" of its 84 channels, the court found only a minimal restriction on the operator's First Amendment rights and upheld the access regulations.

2. Pacific West Cable Co. v. Sacramento, No. S-83-1034 MLS, Mem. Dec. (E.D. Cal. Aug. 14, 1987).

In Sacramento, a would-be cable operator challenged a franchise process in which it had refused to participate, charging the process itself infringed upon its First Amendment rights. The court first submitted to the jury a series of specific questions about the validity of the reasons the government advanced for the franchising process. Sacramento, like Erie, had argued that franchising was justified because cable was a natural monopoly, because a cable system has a serious and disruptive impact on public and private property, and because the government has a responsibility to protect the community's First Amendment rights.

The jury accepted that certain of the public purposes were valid, like those requiring universal service and requiring that the operator be technically and financially qualified. They seemed most impressed, however, with the fact that a group of local investors who had invested only a small sum in the cable system stood to make large profits. Apparently believing that this tainted the franchise process, the jury found many of Sacramento's regulatory purposes invalid.

The court applied the O'Brien test to these jury verdicts, first finding that regulation of cable television is within the constitutional power of local governments in California. It then

went on to balance the governmental interests against the cable operator's interests. Since the jury had found many of Sacramento's justifications for the franchising process to be invalid, and particularly since the jury had found that cable television in Sacramento was not a monopoly, the court found the franchising process improperly kept the plaintiff, Pacific West, out of the Sacramento market. On the plus side, the jury found that plaintiff had suffered no monetary damages.

After the jury verdicts were issued, but before the judge's decision, Sacramento revised its cable television law to permit any operator to receive a license to build a system upon a minimal showing of financial responsibility and compliance with local rules regarding construction and use of the public ways. Sacramento has argued that this enactment gives Pacific West the relief it wants and has moved to dismiss the case as moot. The court has that motion under submission.

3. Century Federal v. City of Palo Alto, No. C-85-2168 EFL, Order (N.D. Cal. Sept. 1, 1987).

In Palo Alto, the court, having decided that a second cable operator had a First Amendment right to construct, determined what terms and conditions the city could impose in the franchise. The city wished to impose four major requirements on all franchisees: Access channels; universal service; state-of-the-art technical requirements; and various bonding, security deposit

and franchise fees. The court found the first three requirements unconstitutional and directed further briefing on the financial questions.

Unlike the Erie and Sacramento cases, the court did not rely for its main analysis on the O'Brien standard recommended by the Supreme Court in Preferred. Rather, the court took an absolutist position, holding that the access and universal service requirements were content-based regulation, not regulation of conduct incidental to speech. In addition, the court found that there were no significant differences between cable and newspapers and, therefore, applied the jurisprudence of print publishing to cable. Since virtually no content-based regulation of newspapers is permissible, the court struck down the access and universal service requirements.

After applying the double-whammy of content-based analysis and the newspaper model to access and universal service, the court applied the O'Brien standard to the state-of-the-art requirements and franchise fees. Here, the court found that the city had produced no evidence that its state-of-the-art requirement would lead to less component replacement and less disruption in the future. As to franchise fees, the court stated its view that they would be sustainable under the O'Brien test, but ordered further briefing on the issue of the constitutionality of each fee requirement in the franchise.

4. Group W Cable, Inc. v. Santa Cruz, No. C-84-7456-WWS, Mem. Op. (N.D. Cal. Sept. 10, 1987).

The most recent case of this quartet, Santa Cruz involves a hold-over cable operator denied renewal by the city as the result of a request for proposal (RFP) process in which the city picked another provider. On summary judgment motion, the court addressed the question whether the specific criteria Santa Cruz applied in rejecting Group W's renewal and RFP proposals violated the First Amendment.

The court applied the O'Brien test to some of the issues in the case, but not to others that the court felt involved content-based regulations. The O'Brien test was applied to the city's justifications for limiting access to a single operator: That the public ways could accommodate only one system; that cable is a natural monopoly; and that permitting more than one system would cause excessive disruption. The court rejected each of these justifications. Although the number of systems that can be accommodated is finite, the court said, the city did not offer sufficient evidence that it cannot accommodate two systems. The court then held that whether cable is a natural monopoly or not is irrelevant because a cable system is analogous to a newspaper and the Supreme Court has held that natural monopoly is not a valid reason for regulating a newspaper. As to physical

disruption, the court held that the city had not offered evidence sufficient to bring the issue into dispute.

Having decided the city could not limit access to a single system, it went on to determine what terms and conditions it could apply to Group W. It found access requirements and technical requirements unconstitutional without reference to the O'Brien balancing test, instead determining such regulations were aimed at content and applying the print model to veto them. The court found some financial qualification requirements valid and others invalid under O'Brien. As to franchise fees, the court determined that the city could require payment of fair market value for the use of the public rights-of-way, and directed the parties to negotiate the amount of such a fee.

III. Future Prospects

These four new federal district court decisions will be added to the brew of previous federal district and appellate court decisions that addressed the propriety of cable television regulation. This mixture of different cases decided by different courts in different contexts, along with cases yet to be decided, will make up the body of diverse and sometimes conflicting views from which the Supreme Court must fashion a consistent interpretation of the constitutional implications of cable regulation.

It is important to remember that federal district court decisions do not overrule other federal district or appellate court cases. Therefore, such important cases as Community Communications v. City of Boulder, Colo., 660 F.2d 1370 (10th Cir. 1981), cert. dismissed, 456 U.S. 1001 (1982), Omega Satellite Products v. City of Indianapolis, 694 F.2d 119 (7th Cir. 1982), and Berkshire Cablevision of Rhode Island, Inc. v. Burke, 571 F.Supp. (D.R.I. 1983), vacated as moot, No. 83-1800 (1st Cir. 1985) are unaffected. Those cases, which predated the Cable Act's endorsement of local authority, upheld cable regulation in the face of First Amendment challenges based on the unique characteristics of the cable medium.

Other significant appellate decisions also include statements that indicate that important aspects of cable regulation will withstand challenge. In striking down the FCC's "must carry" regulation of cable, the District of Columbia Circuit carefully excised cable access regulations from its judgment of unconstitutionality: "Moreover, unlike access rules, which serve countervailing First Amendment values by providing a forum for public or governmental authorities, the must-carry rules transfer control to local broadcasters who already have a delivery mechanism ...." Quincy Cable TV, Inc. v F.C.C., 768 F.2d 1434, 1452-53 (D.C.Cir. 1985). The Eight Circuit recently held that the "'natural monopoly' characteristics of the

Jefferson City (Missouri) cable market justified the City in offering a de facto exclusive franchise..." Central Telecommunications v. TCI Cablevision, 800 F.2d 711, 717 (8th Cir. 1986). The Ninth Circuit, when it heard an earlier appeal in the Sacramento case, stated that "[a]t the very least, Sacramento may regulate the noncommunicative aspects of cable broadcasting through reasonable time, place and manner restrictions." Pacific West Cable Co. v. City of Sacramento, Cal., 798 F.2d 353, 355 (9th Cir. 1986).

In resolving future cable regulation cases, the appellate courts will have to address several key issues. First, are cable regulations to be measured against a newspaper, telephone, or broadcast First Amendment standard, or considered on the basis of its own characteristics? The courts are split on this issue and the Supreme Court has not yet addressed it. In Santa Cruz and Palo Alto, the judges, having adopted the newspaper model, not surprisingly found most cable regulation unconstitutional. Because cable operators in most localities have de facto monopolies that allow them to dictate terms to both suppliers and customers, and because they necessarily must place their systems on public and private property, the newspaper model may not hold up well upon closer examination.

Second, which, if any, cable television regulations are content-based, and which are content-neutral? The answer to this

question determines the stringency of the constitutional test applied to a local regulation. Access regulations are a good example of a municipal regulation whose fate may hinge on whether they are determined to be content-based or content-neutral. While Congress stated its view that access regulations are content-neutral, the courts have split on this issue. In the most recent cases, the Palo Alto and Santa Cruz courts found access regulations content-based, and struck them down. Erie found access content-neutral, and upheld them.

Finally, a key question in future cable cases will be whether courts determine that the public property cable systems use is a "public forum" or not. Public property that has been dedicated, either explicitly or implicitly, to communicative uses is subject to less government control than is public property that is not a public forum. This question too is unresolved, and the recent cases did not deal with it in any great detail. Still, it is a question that the Supreme Court has found to be pivotal in deciding many First Amendment cases and its resolution will undoubtedly have a large bearing on the outcome of future cable cases.

In summary, the definitive word on the constitutionality of cable television regulation has yet to be spoken. The most recent federal district court decisions will likely be appealed. Cases in other cities, like St. Paul and Los Angeles, are

currently moving through the courts, and will provide further grist for the appellate mill. In the end, the Supreme Court must consider all the cable cases from all the circuits and define the permissible area of cable regulation.

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